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# Responding to failure: the promise of market mending for social enterprise

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## ABSTRACT

As more non-profits embrace social enterprise, it is important to examine the role social enterprise plays in society. Market failure is the prevailing economic theory explaining non-profits' existence, and applies to social enterprise. However, market failure theory presents a contradiction: how can social enterprise activities address market failures if they use the market-based strategies that led to that failure? We resolve this contradiction by identifying two responses to market failure: market reallocation and market mending. We examine how these responses align with social enterprise and non-profit conceptions. We discuss implications for strategy, public policy, and research.

**KEYWORDS** Social enterprise; non-profit; market failure theory

## Introduction

Social enterprise as a concept is relatively underdeveloped (Powell, Gillett, and Doherty 2019) and may take on different meanings in different countries or regions (Defourny and Nyssens 2010a; Kerlin 2010). Definitions mainly agree that social enterprise has two broadly defining characteristics: the pursuit of a social mission combined with the pursuit of commercial revenue (Doherty, Haugh, and Lyon 2014). As this definition suggests, social enterprise exemplifies the increasingly blurry lines between the for-profit and non-profit sectors (Dees and Anderson 2003). Blurred sector boundaries obscure the role of social enterprise and the non-profit sector in society. While research has attended to the distinction between social enterprises and for-profits (Austin, Stevenson, and Wei-Skillern 2012), it has paid scant attention to differentiating the roles of social enterprises and non-profits, and it is yet unclear what social enterprises bring to society that existing non-profits do not or cannot. There is a need to better understand how social enterprise is additive or duplicative of non-profit sector efforts (Calò et al. 2018), because activities that are additive will offer the most promising avenues for impact.

Market failure theory remains the prevailing economic theory to explain the role of non-profits (Steinberg 2006). When for-profit firms fail to provide particular goods and services efficiently through the market, and when the government does not intervene (Weisbrod 1975), non-profits are formed in an effort to fill the gap and

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provide a social safety net. Social enterprise addresses the same market failures as non-profits (Austin, Stevenson, and Wei-Skillern 2012; Tan and Yoo 2014; Young et al. 2019). However, social enterprise relies heavily upon market-driven approaches, specifically the generation of commercial revenue. This presents a contradiction: how can social enterprise activities respond to market failures if they rely on the market-driven approaches that caused the market failure in the first place? Santos (2012) suggests that social enterprise addresses market failures by focusing on value creation rather than value capture as traditional for-profits do. But existing non-profits also focus on value creation, so is social enterprise something additive?

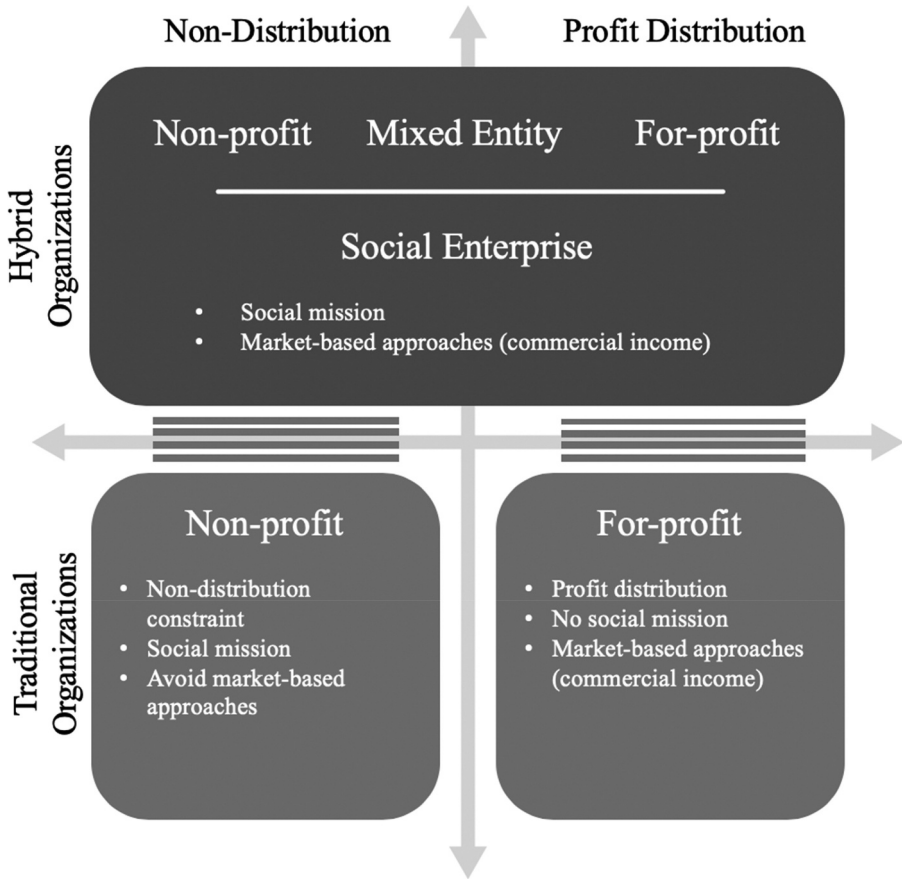
We explore two ways in which social enterprise differentially responds to market failures: market reallocation and market mending. By exploring these two responses and comparing them to the responses of existing non-profits, we can better understand the additive and duplicative roles social enterprises play in comparison to existing and more traditional non-profits. We offer two examples of social enterprises, each drawing on one of these market failure responses. We suggest that these responses are theoretically distinct and have different organizational strategy, public funding, and policy implications.

### **Social enterprise, non-profits, & market failure**

Social enterprise embodies a set of activities ‘combining the pursuit of financial objectives with the pursuit and promotion of substantive and terminal values’ (Cho 2006, 36). Because it combines these two objectives, one drawn from the non-profit sector and one from the for-profit sector, organizations drawing on social enterprise activities are considered hybrid (Battilana and Lee 2014). These hybrid organizations can take on a range of legal structures including non-profit (e.g., 501(c)3, charitable incorporated organization), for-profit (e.g., C Corp, S Corp, LLC), newly defined designations (e.g., CIC, L3C, BCorp), or mixed entity structures that contractually bind distinct legal entities (Haigh, Dowin Kennedy, and Walker 2015). As such, it is important to recognize that non-profits, for-profits, and organizations drawing on social enterprise activities (commonly referred to as ‘social enterprises’) are different, but overlapping, categories of organizations. Figure 1 illustrates these overlaps and distinctions, recognizing the blurry boundaries between them.

Past work has focused on the distinctions and overlaps between for-profits and social enterprises. Santos (2012) explains that for-profits seek to maximize value capture – the appropriation of value into profits – while social enterprises seek to maximize social value creation regardless of how much of that value is appropriated. This paper focuses on clarifying the distinctions and overlaps between non-profits and social enterprises, which both focus on value creation, to understand whether social enterprises are additive<sup>1</sup> or duplicative of existing non-profit efforts.

There are two distinctions between traditional non-profits as a category of organization and social enterprises. First, non-profits are required to comply with a non-distribution constraint, whereby they are precluded from distributing profits to private entities (Frumkin 2002), while not all social enterprises are bound by this constraint. Second, non-profit funding has historically come from contributions and grants, while



**Figure 1.** Social Enterprise, Traditional Organizations, & Blurred Boundaries.

social enterprises borrow practices from the for-profit sector to develop commercial revenue streams to support their missions (Battilana and Lee 2014).

Despite these general distinctions, the intersection between social enterprise and non-profit organizing is large and rapidly growing. In 2013, almost half (47.5%) of U.S. non-profit revenue was commercial income (McKeever 2015). Charitable non-profits are increasingly adopting commercial revenue streams (Weisbrod 1998), even in sub-sectors such as human services that have not traditionally been associated with fees (Grønbjerg 2001). The most common explanation for this trend is that non-profits are attempting to replace waning government funding with commercial income (LeRoux 2005). One study found that, within a sample of Detroit social service non-profits, 20% had adopted at least one commercial income source between 1998 and 2002 (LeRoux 2005). For instance, the Young Men's Christian Association (YMCA) has, over time, added to its services upscale gyms in affluent neighbourhoods (Weisbrod 2004). Thus, many non-profits show interest in developing social enterprises – an enthusiasm that is shared by researchers as well as government officials.

### **Research and theory on social enterprise**

In the past two decades there has been a dramatic increase in interest in social enterprise (Battilana and Lee 2014). This growth is attributed to several social, economic, and political trends (Doherty, Haugh, and Lyon 2014). Despite its popularity, until recently, work in this area has remained relatively atheoretical (Dacin, Dacin, and Matear 2011). A majority of studies treat social enterprise as a new phenomenon, focusing on empirically exploring the advantages and challenges of adopting social enterprise, but overlooking the question of how social enterprise contributes something new to society.

Research shows that there are many advantages for organizations employing social enterprise activities. Commercial income allows social purpose organizations to operate with greater autonomy, flexibility, and financial independence (Kim 2016; Salamon 2001); improve their organizational capabilities (Klein et al. 2013); and decrease their financial vulnerability (Carroll and Stater 2009; Keating et al. 2005). Non-profits' adoption of commercial income fosters revenue diversification (Mendoza-Abarca, Anokhin, and Zamudio 2015; Mendoza-Abarca and Gras 2019), reducing dependence on traditional non-profit funders like governments and donors (Dees 2007; LeRoux 2005). Many governments have increased their support of social enterprises, because they view them as a more financially sustainable avenue for public service provision (Powell and Osborne 2018).

Though the pursuit of commercial income may offer non-profits sustainability, it also presents challenges and risks to the organization (Bingham and Walters 2013). Many argue that the activities associated with the pursuit of commercial income do not align with organizations that emphasize social welfare (Brown 2018; Dees 2012; Fitzgerald and Shepherd 2018; Jeavons 1992; Pache and Santos 2013). Eikenberry and Kluver (2004) argue that commercial income may lead non-profits to compromise their contributions to civil society for instance by: favouring clients who can pay, ignoring complex clients, and discouraging civic participation. Indeed, non-profits with commercial income ventures report negative impacts to their mission and service delivery (Guo 2006) and decreased compensation to their employees (Ghosh Moulick et al. 2020). The risk of mission drift is a known problem in social enterprise (Cornforth 2014).

Work that theorizes social enterprises portrays them as an institutional phenomenon, a hybrid amalgam of two distinct objectives, logics, or identities (Battilana and Lee 2014; Pache and Santos 2010; Wry and York 2017). A large body of research examines the internal impact of these institutional forces and how social enterprises respond (Battilana et al. 2015; Beaton 2019; Smith, Gonin, and Besharov 2013). The adoption of activities from both the for-profit and non-profit sectors can create tension within hybridized organizations (Pache and Santos 2013; Teasdale 2012). This tension can lead to competing sets of norms and expectations that can threaten organizational legitimacy (Battilana and Dorado 2010; Battilana and Lee 2014). However, a variety of choices between legal (Dowin Kennedy and Haigh 2018; Haigh, Dowin Kennedy, and Walker 2015), organizational (Chew 2010; Kistruck and Beamish 2010), and governance structures (Dowin Kennedy, Beaton, and Haigh 2020; Ebrahim, Battilana, and Mair 2014; Fazzi 2012) can help assuage this tension.

Extant research does much to explain the organizational implications of social enterprise, but it does less to explain the societal implications. Though some research

concentrates on evaluating the social impact of social enterprises (e.g., Bagnoli and Megali 2009; Cooney and Lynch-Cerullo 2014; Ebrahim, Battilana, and Mair 2014), we argue that more theoretical attention must be given to what social enterprise brings to society, especially the ways in which social enterprise might be additive to, rather than duplicative of, the efforts of existing non-profits. Stated more simply, why do we need social enterprise when we have non-profits? We turn to market failure theory to assist in answering this question and thereby theorize the role of social enterprise in society.

### **Market failure theory**

Market failure (Bator 1958) is the prevailing economic theory explaining the existence of non-profits (Steinberg 2006). Markets are defined as ‘conceptual space[s] where items of value are exchanged’ (Young et al. 2019, 165). Exchange occurs when two parties each have something of value to trade for something they wish to consume. In a properly functioning market there is sufficient choice and competition such that the market operates efficiently. In a perfectly performing market, non-profits would not exist (Ott and Dicke 2012), but sometimes markets fail. Market failure is defined as ‘the inability of a market or systems of markets to provide goods and services either at all or in an economically optimal manner’ (Dollery and Wallis 1997, 115) and is the basis of government intervention in market economies. According to this theory, non-profits appear under conditions in which the market has failed and the government also fails<sup>2</sup> (Salamon 1995; Weisbrod 1975). Non-profit organizations play an important role in securing the social safety net because of the fallibility of markets (Salamon 1987).

There are numerous reasons markets fail to meet the needs of society and non-profits are formed to step in (Hansmann 1980; Weisbrod 1988). First, markets struggle to provide public goods because of the challenges of appropriating pecuniary rewards (Dollery and Wallis 1997). The supplier cannot restrict access to public benefits only to those who pay for them, which often creates a thin market in which a small number of consumers who are willing to pay are burdened with the costs of free riders (Young et al. 2019). Second, markets struggle to account for the externalities of their transactions, which create inefficient markets that fail to reflect the true social costs or benefits (Dollery and Wallis 1997; Young et al. 2019). Third, information asymmetries between suppliers and consumers mean that those engaged in an exchange are unable to make informed decisions, creating opportunities for exploitation and gaps in desired goods (Hansmann 1980). Fourth, incomplete markets can cause market failures when demand does not sufficiently cover the cost of provision, or there is a lack of complementary markets to support the broad range of consumer needs (Dollery and Wallis 1997). Finally, transaction costs can cause market failure when the goods and services provided are complex, if there are barriers to trade (including physical, cultural, and institutional), or if the market is difficult to police (Young et al. 2019). When at least one of these conditions is present, and the government does not intervene, non-profit organizations are established to fulfil unmet demand.

Non-profits address the consequences of market failure, plugging holes in coverage and access that are left by traditional market entities for the reasons outlined above. The non-distribution constraint of non-profits positions them to create public benefit with surplus funds that would traditionally go to private owners. For instance, the non-distribution constraint enables provision of the arts. Non-profits such as museums

provide a public good with positive externalities. Museums preserve the cultural heritage of a community, a sense of pride and belonging from which everyone benefits. In addition to offering the enjoyment of art itself, museums provide positive external benefits by educating children and adults, making them better citizens. A for-profit organization could operate a museum, but it would exclude those who could not pay enough or at all in an attempt to generate profit, creating an inefficient market (Young et al. 2019). Non-profit museums can lower the cost of admittance or subsidize free visits with donations paid by individuals who trust that a non-profit will responsibly steward their funds, whereas a for-profit is more likely to use those funds for private enrichment.

Social enterprise uses market-based solutions to address the same market failures as non-profits (Austin, Stevenson, and Wei-Skillern 2012; Tan and Yoo 2014). In fact, some museums could be called social enterprises, because many of them source a significant proportion of their income from ticket sales. This presents a paradox. Social enterprises use market-based approaches when a market is flawed. If non-profits can address market failures because their non-distribution constraint makes them fundamentally different from for-profits that have failed, it is puzzling that a social enterprise, that draws heavily on market-based approaches and/or does not comply with a non-distribution constraint, might do the work of addressing market failures effectively. Further, as non-profits increasingly adopt social enterprise activities, becoming more like for-profits, they may erode the social safety net by preventing non-profits from playing their role in addressing the deepest market failures. Both non-profits and social enterprises rely on benefits accumulated from a strong non-profit sector including legitimacy, funding, and service-delivery (Child 2016), which can be jeopardized if they are viewed as being too business-like. Many fear that the trend of non-profits adopting social enterprise could compromise the spirit and trust engendered by the sector (Bush 1992).

Better understanding the role of social enterprise in society and the value it adds beyond non-profit organizing would address such concerns. Following Calò et al. (2018) and Child (2016), we assert that social enterprise should add to current service offerings, not merely duplicate or replace existing non-profit offerings. The objective of this article is to examine and delineate the distinctive characteristics of social enterprises and the role they can play in responding to market failures. Next, we consider two ways in which social enterprises respond to market failures – one that duplicates and one that adds to the efforts of traditional non-profits.

### **Social enterprise responses to market failures**

We identify two ways in which social enterprises respond to market failure: market reallocation and market mending. *Market reallocation* involves reallocating financial resources from healthy, properly functioning markets to markets that have failed. *Market mending* involves rectifying frail, poorly functioning markets to ensure that a broader segment of the population can participate in the market. While this is not an empirical study, for illustration purposes, we draw on two American organizations that have been referred to as social enterprises in order to exemplify these responses to market failure. The examples are selected on a theoretical basis (Eisenhardt 1989) because of how they respond to market failure. The organizational descriptions are developed from publicly available information to shed light on how social enterprises respond to market failures.

### ***A description & example of market reallocation***

One response to market failure is to earn income in a healthy market and then expend that income to address a failed market, which we call market reallocation. Reallocation highlights an area of duplication with many existing and traditional non-profits. Traditional conceptions of non-profits portray them as primarily reliant on philanthropy. These non-profits are market reallocators, because they reallocate financial resources from the market for philanthropy (Andreoni 2016; Brown and Slivinski 2006; Karlan and List 2007; Young et al. 2019) to resolve issues that exist due to a market failure. Homeless shelters, and many other non-profits supporting the disadvantaged, lack a source of commercial income, so they ask donors to reallocate for them. A donor may contribute to a homeless shelter in the market for philanthropy – funds that are reallocated to address the failed market for housing. However, for a variety of reasons, the market for philanthropy is not necessarily an efficient market (Rose-Ackerman 1982). For instance, donating has significant transaction costs, not the least of which is the cost of a donor's time spent overcoming information asymmetries (Cnaan et al. 2011). To make an educated decision regarding their contribution, donors must spend time learning about the plethora of non-profits, what they do, and how their programmes operate. This makes the market for philanthropy a precarious source of income. Commercial income, which ideally relies upon a healthy, stable market and depends mainly upon the strategies and actions of the organization itself, can be a more reliable source than philanthropy.

As a result, some non-profits reallocate from markets other than the market for philanthropy. Non-profits in many subsectors, such as health, education, and the arts, have depended upon commercial income for many years. For instance, decades ago, museums began to increase their reliance on commercial income by raising fees, but also by creating on-site stores to sell merchandise and then expanding those stores to malls (Toepler 2006). The profits from a healthy market for merchandise sales are reallocated to supply art exhibits, a failed market.

Many notable social enterprises also respond to market failure by reallocating across markets. One market failure where social enterprises have been introduced is the labour market. The labour market often excludes individuals who have the potential to be productive. A range of non-profit and for-profit work integrated social enterprises (WISEs) have been developed to support various underemployed groups – including veterans, previously incarcerated individuals, individuals with former substance abuse issues, homeless individuals, and individuals suffering from mental health conditions (Cooney 2011; Hazenberg, Seddon, and Denny 2013; Pache and Santos 2013). Employing these workers comes with high transaction costs, because they need additional training and coaching to perform their duties, which is why the labour market has failed to employ them. WISEs identify healthy markets in which underemployed individuals can provide products or services, which will also simultaneously provide individuals with work and provide the organization with revenue to support those programmes.

We use a WISE called Cara<sup>3</sup> to highlight how social enterprises use market reallocation to address a market failure. Cara is a non-profit based in Chicago. Founded in 1991, its mission is to 'unlock the power and purpose within our communities and ourselves to achieve real and lasting success,' and it has sought to help people affected by poverty obtain and maintain quality jobs. As such, Cara's efforts are



directed at addressing a failed labour market whereby individuals who are homeless or in poverty are excluded. At Cara, participants go through a five-stage training and placement process with continued support throughout the first year of employment to encourage their success. For-profits are typically unwilling to assume these extra costs, which leads to a failed labour market.

Cara operates with two wholly owned limited liability subsidiaries, one of which is Cleanslate, a maintenance service (litter abatement, landscaping, and snow removal) that employs the homeless. Cleanslate draws on a labour reallocation model in which the enterprise extracts money from a functioning market to incorporate workers who would otherwise be excluded from the job market. Cleanslate supports the Cara organization in three ways: it provides experience to participants; it offers participants a chance to earn income and learn skills; and the surplus revenue funds Cara's other programming.

Cleanslate has contracts with businesses and government agencies that have typically been awarded to traditional for-profits. It competes within these functioning markets, but reallocates that revenue to address a flawed labour market. Cleanslate does not create a new market or fundamentally alter the market for beneficiaries. Instead, it inserts itself within an existing, healthy market and competes for revenue in that market.

There are at least five ways that organizations can engage in reallocation: philanthropic reallocation, in-kind reallocation, commercial reallocation, labour reallocation, and socioeconomic reallocation. These are described and illustrated with examples in [Table 1](#). Other examples of social enterprises playing a reallocation role include The Red Cross, Girl Scouts, Tom's Shoes, and Digital Divide Data.

By examining Cara's reallocation role, we recognize that, for the most part, this response to market failure is not new, despite the fact that social enterprise is sometimes presented as a novel approach (Kerlin 2010). As [Table 1](#) shows, there are well-established non-profits that engage in each of these forms of market reallocation. In fact, non-profits have been playing a reallocation role for decades. One of the examples in [Table 1](#), Goodwill Industries, began employing the poor to repair donated items over 100 years ago. Today, that organization reallocates from philanthropy (donations), in-kind (thrift stores), and commercial (conference fees) sources to the labour market (employment programme). Thus, from the perspective of the non-profit sector, market reallocating social enterprises are duplicative – they are not new, and they are doing what many non-profits have been doing for some time.

### ***A description & example of market mending***

Market mending is a second response to market failure, which involves creating new products and business models that give beneficiaries access to goods and services through market transactions. Market mending goes beyond reallocation, which provides a market stopgap, by actively seeking to mend that gap. Martin and Osberg (2015) assert that a key distinction between social enterprises and many non-profits is that social enterprises explicitly seek to alter the status-quo of the failure, while many non-profits focus on social service provision in the absence of a trusted market-based solution. A focus on altering the status quo reflects an additive role for social enterprises as market menders, while market reallocating social enterprises are more likely to duplicate the role of existing non-profits.

Table 1. Market Reallocation Models.

	Explanation	Examples
<b>Philanthropic Reallocation</b> (reallocation from philanthropy market to failed market)	Collecting donations, reallocating money from donors to a failed market	<b>United Way</b> , the US's largest non-profit by donations, distributes money to local affiliates to invest in their communities. Other examples: Human Rights Watch, Greenpeace, World Vision
<b>In-kind Reallocation</b> (reallocation from in-kind donation market to failed market)	Collection of unused or lightly used goods, reallocating those goods (or revenue from the goods) to a failed market	<b>The Red Cross</b> takes blood donations and distributes them to ill or injured patients, particularly those affected by natural disasters. Other examples: Habitat for Humanity ReStore, Foodbank Australia, British Heart Foundation
<b>Commercial Reallocation</b> (reallocation from healthy commercial market to failed market)	Earning income for products and services sold to fund a failed market	<b>Girl Scouts</b> sells cookies to members of their communities. The sales experience teaches young girls about leadership and the proceeds support other developmental activities. Other examples: The Smithsonian, LifeStraw, Tom's Shoes
<b>Labour Reallocation</b> (reallocation from healthy consumer market to failed labour market)	Hiring individuals with employment challenges from a failed labour market, but compete with profit-seeking firms for sales	<b>Goodwill Industries</b> employs those struggling to find a job. These individuals may be hired at Goodwill's retail locations or through Goodwill's custodial and security businesses. Other examples: Cara Cleanslate, NOW Group, Digital Divide Data
<b>Socioeconomic Reallocation</b> (reallocation from wealthy buyers in a market to low-income buyers in the same market)	Differentiating pricing so that wealthier patrons subsidize low-income patrons in a failed market	<b>Mayo Clinic</b> is a world-renowned hospital that, like many hospitals, provides discounts and financial assistance to the underinsured, uninsured, and those with hardship. Procedures for insured patients subsidize these discounts. Other examples: Oxford University, the Metropolitan Museum of Art

One example of a market mending social enterprise is SimpleCitizen,<sup>4</sup> a for-profit founded in 2014 that defines itself as ‘a digital immigration and visa solution designed to streamline the pathway to citizenship.’ SimpleCitizen has created a low-cost platform for individuals seeking US citizenship to access information, complete required forms, and monitor their application progress. This platform makes the process of acquiring citizenship accessible to a wider range of people seeking to legally remain in the US. The immigration process in the US is complicated and difficult to navigate on one’s own, because information is fractured across many platforms and agencies and the paperwork required is daunting. Individuals applying for citizenship need to construct an application packet that includes nearly 80 pages of documentation, and they are faced with the choice of paying a lawyer thousands of dollars or spending significant time assembling the documentation themselves – a task that is especially challenging for individuals who may not speak English as their first language.

The market failure SimpleCitizen addresses is a dramatic information asymmetry between individuals seeking citizenship and government agencies. Hiring a lawyer could correct this asymmetry, but individuals must pay high hourly rates to a bar holding attorney for knowledge that does not require a law degree, which excludes many people who wish to complete an application. Further, only a fraction of lawyers has direct knowledge and experience of the citizenship process, and it can be challenging for an individual to access an immigration attorney even if they have the ability to pay.

SimpleCitizen mends this gap in the market by reducing the information asymmetry and increasing accessibility to information. The SimpleCitizen online platform offers a step-by-step process with tutorials in multiple languages. Customers can take photos and upload evidence to the website, and the software assembles the documentation. The company offers a range of services from employment authorization to green card applications with pricing that ranges from 25 USD-\$650. These services can be accessed across a nearly global geographic range at a fraction of the cost of hiring an immigration lawyer, significantly expanding the number of people with access to immigration services.

While there are non-profits functioning within the space of US immigration support, these organizations are reliant on the generosity of law firms that donate time and philanthropic gifts, seriously limiting their ability to meet demand. For example, the Immigration Advocates Network connects people needing immigration support with law firms willing to take on pro-bono casework. In contrast, SimpleCitizen’s digital platform is designed for scale, and it allows individuals to work through the process relatively autonomously.

SimpleCitizen is not alone; many social enterprises play the role of market mending, and these enterprises employ a range of models. Four potential mending models include: void mending, bridging mending, last mile mending, and inclusive mending. These models are described in [Table 2](#) with illustrative examples that include Embrace Innovation, Dr Noah Toothbrushes, and Runa.

We suggest that market mending is a distinct role for social enterprise to play and that it is the domain in which social enterprise can contribute the most to society. Market mending social enterprises engage beneficiaries in market transactions instead of relying upon reallocation from a healthy market. For this reason, the market mending role seems to be played by for-profit firms, as is the case in most of our

Table 2. Market Mending Models.

	Explanation	Examples
<b>Void Mending</b> (mending a market by creating new products or services to complement existing markets)	Building markets where voids exist by creating products and services that would not otherwise exist at any price point	<b>Embrace Innovations</b> is a medical device company that developed a fundamentally different incubator to support low birth-weight babies born in countries with poor infrastructure. These incubators, which look like sleeping bags, use a phase change wax packet that can be heated in boiling water and hold its temperature for eight hours. Other examples: Husk Power Systems
<b>Bridging Mending</b> (mending a market by facilitating market transactions between previously disconnected suppliers and consumers)	Connecting consumers and suppliers, both of whom have the capability to participate in the market, but otherwise would be disconnected because of geographic barriers, complicated supply chains, or lack of information	<b>Runa</b> is a beverage company that connects indigenous Kichwa producers of Guayusa (an indigenous caffeinated tea product) in Ecuador with customers in the US and Europe. Other examples: Timewise, Good on You
<b>Last Mile Mending</b> (mending a market by increasing access to that market)	Building distribution networks to ensure that existing products can reach more potential customers, products that can improve their lives or livelihoods	<b>Solar Sister</b> sells solar lights and clean cook stoves in Northern Africa by creating a distribution network of female entrepreneurs who sell the products within their remote villages. This distribution model provides customers with access to clean technology and provides women with the opportunity to earn income by selling the products. Other examples: Driشته
<b>Inclusive Mending</b> (mending a market by including more buyers in that market)	Helping those who have historically been marginalized from the market to participate, either by lowering barriers to entry or by offering a lower cost solution.	<b>Acumen Fund</b> offers business banking and financing services to individuals who have traditionally been excluded from formal bank and investment networks because of lack of credit scores and lower income thresholds. Other examples: SimpleCitizen, Aravind Eye Care, Dr Noah Toothbrushes

examples. However, the markets in which market mending is needed have historically failed, making them challenging and risky to enter. As a result, social enterprises doing this work require distinct strategies and support if they wish to succeed.

### **Market reallocation & market mending**

The roles of market reallocation and market mending are theoretically distinct yet equally important ways to support society. Market reallocation is a conventional approach in the non-profit sector. It is a way to cope with market failures by bringing outside or unrelated resources to bear on a social problem. It is an approach that will need constant, ongoing support. Rather merely than coping with market failures, market mending provides a long-term solution by disrupting the status quo, developing new markets, or repairing existing markets to better meet the needs of marginalized individuals. Market mending involves the innovation and entrepreneurship that is consistent with many descriptions of social enterprise as novel. Both of these roles are central to building a more equitable society. Reallocators are needed to ensure that immediate needs caused by market failure are met, while menders are needed to help close gaps in the market in the long run.

The distinction between market reallocation and market mending is a theoretical one. Because these roles are ideal types, representative of what is essential to each category of organizations, and because organizations can play multiple roles in society, it is surely possible for a single organization to both reallocate and mend, and for an organization to shift from one role to another over time. Some of the examples we describe in [Table 2](#) are characteristic of such blending and transformation. Our observations suggest that these cases tend to exist when social enterprises operate in communities with high levels of poverty but have limited healthy markets from which to reallocate. Solar Sister, a non-profit that employs African women to sell clean energy products, operates in two failed markets. It sells clean energy products to rural Africans who would not have access to these products otherwise, mending the market for clean energy products. The organization also trains and employs female entrepreneurs to sell those products, reallocating from the mended clean energy market to the labour market that has failed to employ these resourceful women. Thus, Solar Sister combines the labour reallocation and last mile mending models. Cases like Solar Sister often exist when social enterprises target beneficiaries in communities with high levels of poverty and vast needs, but that have limited healthy markets to reallocate from. In these cases, social enterprises simultaneously provide novel products and services that did not exist in the market (mending) and opportunities for beneficiaries to earn income by selling the products (reallocation). Further, there is likely a grey area between these roles. For instance, the socioeconomic reallocation model that we describe involves reallocation from one set of buyers in the market (high income) to another set of buyers in the same market (low income). Reallocation occurs within the same market rather than across different markets as in the other reallocation models we describe, making it closer to, but still not fully characteristic of, market mending, which would eliminate the need for ongoing reallocation.

Despite potential overlaps and grey areas, the theoretical distinction presented is useful, because it begins to clarify the additive role that social enterprises can play in society as market menders. Many scholars have developed various typologies of social enterprise (e.g., Defourny and Nyssens 2017; Mair, Battilana, and Cardenas

2012). While those studies have fruitfully taken an inductive approach to categorization, relying heavily on definitions of social enterprise in the literature or in practice, the distinction developed here applies to all organizations aimed at addressing market failures (mission-driven organizations), not merely to social enterprise. The result of this theoretically-driven, deductive approach is a framework for defining not what social enterprise *is* (as an empirical and/or socially constructed concept), but from an economic perspective what it *ought* to entail. We argue that because existing non-profits have a long history and experience in reallocation, what society needs from the ‘new’ concept of social enterprise is mending.

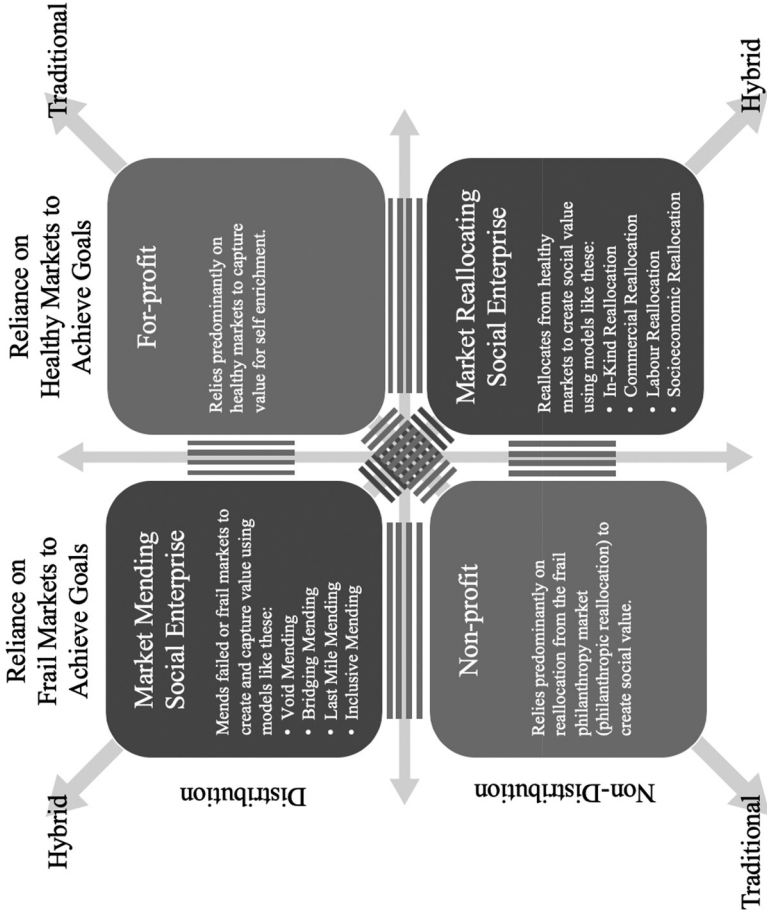
Figure 2 visualizes the proposed theoretical framework (an evolution from Figure 1, which represented extant notions of social enterprise). The distinction between market reallocation and market mending usefully distinguishes the role of traditional non-profits, social enterprise, and traditional for-profits. The framework thus helps to explain the contested meaning of social enterprise. Some argue that social enterprise is not an organizational form per se, but a new label that reflects the evolution of non-profits towards more entrepreneurial or business-like forms (Dart 2004; Dees 1998; Kerlin 2010). Such a perspective aligns with a focus on market reallocating social enterprise, which represents the overlap and intersection of social enterprise and the non-profit sector. Others treat social enterprise as an emerging organizational form that adopts new strategies and structures to make the economy more inclusive (Defourny 2001; Martin and Osberg 2015). This perspective aligns with the notion of market mending social enterprise. This framework has implications for organizational strategy and for public policy and funding, which we discuss next and summarize in Table 3.

### **Implications for organizational strategy**

While it is theoretically possible for a social enterprise to simultaneously serve the market reallocator and mender roles, this may be disadvantageous. Minimally, it is a challenging approach to employ. Market reallocation and market mending require different models and competencies. Due to the significant cost and complexity of simultaneously creating new models for a failed market and reallocating resources from a healthy market, social enterprises that reallocate and mend are likely to have significant survival challenges and difficulty scaling. To explicate these challenges and distinctions, it is important to further consider the markets in which market reallocators and menders operate.

Market reallocating social enterprises generally have the option of a range of healthy markets in which they could operate as long as they can build the skills and competencies necessary to compete effectively. For instance, Cara had the option of entering a variety of different markets and opted into maintenance, because they believed such an enterprise could offer experience and income to their beneficiaries while generating revenue. Cara could have opted to open a restaurant or moving business, but they decided that maintenance was the market with the most potential. As market reallocating social enterprises choose markets from which to reallocate, they should seek markets with high margins to maximize the amount of reallocation possible.

Market reallocating social enterprises tend to be more financially stable than traditional non-profits that rely solely on charitable or government funding (Mitchell 2012;



**Figure 2. Theoretical Framework Based on Market Orientation.** Because market reallocation and market mending are ideal types, and because we expect organizations may incorporate multiple market responses and models, this framework should be regarded as composed of axes rather than mutually exclusive categories.

**Table 3.** Comparing Market Mending & Market Reallocating Social Enterprise.

	Market Mending	Market Reallocating
Market Failure Response	<b>Disrupt the status quo by developing new markets or repairing existing markets</b> to better meet the needs of traditionally marginalized individuals. Operate in a single market.	<b>Take advantage of a healthy, functional market</b> to capture and reallocate revenue to social programmes. Operate in at least two markets: one for customers and one for beneficiaries.
Legal Structure & Governance	Would be better organized as <b>for-profit</b> (or new legal structures) to attract private investment. Need to develop robust governance structures at formation that set distribution constraints and ensure investment in social good.	Would better be organized as <b>non-profit</b> (or mixed entity hybrid) to be able to attract donations and grants. Need strong governance structures that prioritize the voice of beneficiaries over market customers.
Funding Needs & Accountability	<b>Initial funding necessary to incentivize innovation</b> ; developing intellectual property and opening new markets is costly, but should be self-sufficient once running, and corresponding timing benchmarks should be set. Public funding mechanisms might include <b>short-run tax credits or no-interest loans</b> to complement private capital.	<b>Lasting commitments from institutional funding sources</b> ; commercial income supplements programmes, but may not entirely meet funding requirements. Funders should assist in establishing ongoing performance benchmarks. Public funding mechanisms would include <b>multi-year contracts or grants</b> to complement philanthropy.
Risks	<b>Start-up capital may be wasted</b> if innovation is unsuccessful; without careful screening <b>funding programmes could be exploited</b> for commercial gain with limited social impact.	Market-based activity may <b>displace social aims</b> if appropriate governance and accountability structures are not put in place, in part because market customers and beneficiaries are distinct populations.



Parris et al. 2018; Powell, Gillett, and Doherty 2019), because they draw, at least in part, on healthy, functioning markets for income. However, there are downsides to income generated in a separate market that stems from managing increased complexity and trade-offs between income generation and social mission (Cooney 2011; Smith and Besharov 2017; Teasdale 2012). Cara's Cleanslate has to fully understand both the market for maintenance, in which its customers are purchasing services, and the labour market that is causing its beneficiaries to become unemployed. Market reallocating social enterprises must be well versed in both catering to customers in a healthy market and in social programming that meets the needs of its beneficiaries in a failed market. Developing this type of ambidexterity can be costly, challenging, and distracting. Such tensions have been explored deeply in the literature (Smith, Gonin, and Besharov 2013), which tells us that mission drift is a concern (Cornforth 2014; Ebrahim, Battilana, and Mair 2014), especially when organizations face a 'service paradox' where serving one stakeholder (e.g., customers) may involve failing to serve another stakeholder (e.g., beneficiaries) (Jay 2013). This challenge of dual market capabilities is one an organization should consider deeply, for instance, if a traditional non-profit considers taking up a market reallocating social enterprise.

Conversely, market menders need only understand a single market, because they operate in the market where they recognize the failure – earning their income directly from the end consumer. The founder of SimpleCitizen and his girlfriend were unable to find an affordable option in the market when they were seeking to secure a green card for her to remain in the US. Their options were to spend thousands of dollars on a lawyer, which was out of their financial reach, or to spend hours completing the complicated application package, which had transaction costs as they dealt with a lack of information and skill. In order to fix this, he developed a new product that reduced those transaction costs and information asymmetries. By creating an online platform, SimpleCitizen is able to offer a new product in the market for citizenship support services that is additive to the efforts of existing non-profits. Thus, market mending requires innovation, whereby new concepts are developed in order to meet consumer needs. The challenges market menders face include the need for innovation, the upfront costs necessary to innovate, and the risk that the developed innovation will underperform in the marketplace.

In part because of these distinction challenges, market reallocators and market menders differ in the legal forms and governance structures that are suited to their goals (Spear, Cornforth, and Aiken 2009). Market reallocators are better organized under a non-profit organizational form or as a mixed entity structure in which a for-profit entity is wholly owned by a non-profit, as is the case with Cara and Cleanslate. Because market reallocators are tasked with stewarding funds from another source, these organizations need to be highly trusted. In addition, because market reallocators operate in two markets (a healthy one and a failed one), it is important that careful attention is paid to the governance structures developed to ensure that the voice and needs of beneficiaries will be prioritized over those of market customers to prevent misalignment of the mission upon which the social enterprise is founded (Ebrahim, Battilana, and Mair 2014). A non-distribution constraint can be useful to that end.

Market menders, on the other hand, are better organized under a for-profit legal form (including new legal forms that allow, but limit, profit distribution), because these enterprises most resemble traditional entrepreneurial ventures. While they may experience lower profits than traditional firms, they have the long-term potential to

derive profits from their consumers and distribute them to owners. As a result, they will be able to access a broader pool of capital necessary for intellectual property development and scale. When establishing these enterprises, care should be taken to ensure that governance structures are developed at formation that set distribution constraints and ensure investment in the social good.

As we have outlined here, the market reallocator and market mending roles invoke different competencies and are suited to different legal and governance structures. Future research can further develop these implications with empirical research. In particular, more work is needed to examine the prevalence of these types of organizations and to identify and clarify the models associated with market reallocation and market mending. We have given a brief list of market reallocation and market mending models (Tables 1 and 2) based on our observations, but these lists are precursory, certainly not exhaustive, and need further development.

### ***Implications for public funding and policy***

To this point, our theoretical framework has assumed that a government failure has coincided with a market failure. However, social enterprise exists at the crossroads of not only the market and civil society, but also public policy (Nyssens 2006), and the government has the means to maximize social value creation through public funding and policies directed at market reallocating and mending social enterprises. Public funding and policy choices should reflect the distinct benefits that organizations relying on each of these responses offer.

Market reallocating social enterprises rely on commercial income (and sometimes also philanthropy). However, commercial income often fails to fully meet financial requirements. We have suggested the selecting high margin markets can assist in closing this gap, but even in high margin businesses these enterprises may have a hard time making ends meet. Targeting market reallocating social enterprises for public procurement and similar contracts is a useful way for the government to support these enterprises. Sustained public funding in the form of contracts for services or multi-year grants will be beneficial for ensuring these programmes are able to provide ongoing support to their communities.

Market mending social enterprises, on the other hand, are reforming markets and would ideally be self-sustaining. They are also the most additive to existing non-profit efforts, so governments should encourage and incentivize the formation of these enterprises. Governments that support social enterprise incubators or accelerators may want to direct focus at the creation of market mending social enterprises. In terms of financial support, instead of needing ongoing funding commitments, these social enterprises would benefit most from seed funding that would incentivize innovation and risk-taking from social entrepreneurs. As we have suggested, mending markets can be risky. There are reasons why market-based solutions have not already corrected a failed market, and those challenges must be overcome, creating an economic risk (Defourny and Nyssens 2010b). Developing intellectual property and establishing new markets is costly, and public support in the form of short run tax-credits, no-interest loans, or government guaranteed loans would help mitigate the risk involved. A clear timetable and benchmarks for progress should be established to qualify for this type of funding. If governments want to provide ongoing support to market mending social enterprises, they can do so through vouchers that subsidize consumers for their purchases. Social enterprise policymakers can also facilitate and

incentivize the creation of social enterprise ecosystems that support market mending by helping to funnel private investment into these enterprises (Choi, Berry, and Ghadimi 2020). For instance, policymakers could encourage socially responsible investment options through tax benefits for investors, social impact bonds, or the creation of a social stock exchange as seen in the UK.

Government funders should be aware of the risks in the case that market-based activity is poorly managed by both market reallocating and mending social enterprises. Market reallocating social enterprises must be aware that market-based activity may displace social aims if the appropriate structures are not in place. Under a market reallocation model, customers and beneficiaries are distinct groups, which has been posited to increase the risk of mission drift (Santos, Pache, and Birkholz 2015). Cara Cleanslate customers are companies purchasing maintenance services, and their beneficiaries are homeless individuals. As the organization becomes more dependent on commercial income, it may become challenging to ensure that the needs of beneficiaries are prioritized if they are in direct conflict with the needs of customers, which can lead to mission drift (Cooney 2006). This is why market reallocating social enterprises are best organized as non-profits, as that there is less incentive to accumulate profits. Policymakers have the ability to encourage and incentivize reallocators to structure themselves as such. It would also be valuable to implement governance practices that include beneficiaries on the board of directors in order to help mitigate this risk – something that both public funders and policymakers have the ability to mandate.

Market mending social enterprises do not share this problem, because their customers and beneficiaries are the same people. SimpleCitizen's customers and beneficiaries are immigrants purchasing citizenship application services. Instead, the primary risks of market mending social enterprises are that they may fail to yield a successful innovation and that programmes established to support early stage social innovation may be exploited by individuals without social interest at the heart of their enterprise, both of which would waste limited public funds that otherwise would have been allocated to supporting more established interventions. It is essential that robust screening protocols are established that can help protect public investment. Further, requiring the social enterprise to award a small equity stake in exchange for early stage support may help ensure that the public at large can reap the benefits of a successful intervention and provide a funding vehicle for future social enterprise investment that does not divert funds from the immediate work of market reallocators.

## **Conclusion & future research directions**

Social enterprise is a popular concept in academia and in practice. While many non-profits are adopting social enterprise activities, it is not yet clear what the societal impact of this trend will be. Specifically, it is important to determine whether social enterprise is additive or duplicative of existing non-profit efforts. In order to better understand the societal impact, academics need to offer better theories for, and tests of, the role of social enterprise. Applying market failure theory to the concept of social enterprise helps to explain the ways in which organizations of all types are responding to market failures. We identify two ideal type responses of social enterprises to market failure: market reallocation as illustrated by Cara Cleanslate and market mending as exemplified by SimpleCitizen.

Identifying these two roles allows us to compare how social enterprise and non-profits address market failure. Existing non-profits tend to rely on market reallocation, reallocating funds from one market to address a problem in a failed market. By drawing upon commercial income, market reallocating social enterprises improve the stability of the reallocation process; commercial income ideally relies on a healthy, high-margin market whereas the market for philanthropy is less stable. Even so, the reallocation of commercial income sources to social causes has been occurring in the non-profit sector for many years and is not a new phenomenon. What the concept of social enterprise brings to society is the market mending role. Market mending social enterprises enter a failed market and alter that market in ways that make the market function more efficiently. In doing so, they offer a long-term solution to a failed market. The difference between market reallocating and market mending social enterprise is that the latter is new and progressive and the former is not.

Market mending social enterprises have long-term stability built into their models and should not share the ongoing investment needs of market reallocating social enterprises and traditional non-profits. Instead, they should be supported in their initial development through seed funding. The difference in ideal funding strategies is just one of the practical implications of our theory. We also suggest legal and governance structures for each. Students of social enterprise and social entrepreneurship may benefit from understanding this theoretical distinction and developing its implications (Wiley and Berry 2015).

The proposed theoretical framework based on market orientation requires much future research and testing. We have already outlined some questions worthy of examination, but there are several others. We selected Cara Cleanslate and SimpleCitizen to illustrate our theory. Future work could test our categories by applying them to a larger sample of social enterprises. It is possible that an inductive study of a sample of social enterprises may find additional market failure responses through which social enterprises, or organizations generally, address market failures. Because the market reallocator and mender responses are simplified ideal types, we expect that in practice these approaches may be combined in much the same way that Goodwill Industries adopts multiple reallocation models. In-depth case studies and case comparisons of market reallocating and market mending social enterprises could answer this question by examining the ways in which market failure responses are combined. Such studies could also help us to discover more about the structures that are optimal for these endeavours. We have proposed certain legal, funding, and governance structures that would benefit each response, but future work could more deeply explore these propositions.

Finally, although we have identified some examples of market reallocating and market mending social enterprises from various parts of the world, our examination has been US-dominant. In other regions of the world, such as the UK, social enterprise intersects more deeply with the public sector than in the US. The public sector uses what one might describe as non-market reallocation to address market failures, because it predominately accumulates financial resources through taxation. The intersection between social enterprise and the public sector might be fruitfully examined by recognizing social enterprises as non-market reallocators or through government failure theory by examining how social enterprises respond to different government failures, such as the categorical and majoritarian constraint (Young 1998).

Based on our framework, we propose the following future research questions as a roadmap for future work:

- How prevalent are market reallocating and market mending social enterprises? Are different market failure responses more common in different regions of the world? Do political context, public funding structures, or policies for social enterprise impact the use of reallocation and mending?
- Are there additional market failure responses beyond reallocation and mending? To what extent do organizations combine market failure responses (reallocation and mending)? How effective is such a combination? To what extent, and under what conditions, do organizations transition from one response to another?
- What business models, strategic capabilities, and legal and governance structures are associated with, or lend themselves to, market reallocation and market mending? Are there additions or revisions needed to the list of models described in Tables 1 and 2?
- How do organizations respond to different types of government failure? How do those responses compare to the responses to market failure?

Overall, we expect that a deeper examination of market reallocation and market mending as distinct roles for organizations, including social enterprises, may disentangle some complexities. Ultimately, we hope the related theoretical and practical insights may unlock the potential of social enterprise in addressing our social challenges better than through for-profit or non-profit organizations alone.

## Notes

1. By additive we have in mind a meaning similar to what Young (2006) refers to as ‘supplementary’ when he describes the relationship between non-profits and the government. However, because the government tends to partner with, rather than compete with, non-profits to provide public services (Salamon 1995), Young’s typology does not have a corollary to what we describe as a duplicative relationship.
2. Government failure theory outlines conditions under which non-profits appear because the government has (voluntarily or involuntarily) failed to provide a needed service. Thus, for non-profits to appear, both the market and the government must have failed. For purposes of this paper, we consider when both the market and government has failed but focus on the underlying market conditions.
3. Data used to build this case write-up are drawn from: <https://carachicago.org/>; <https://caraconnects.com/>; <https://cleanslatechicago.org/>; <https://carachicago.org/app/uploads/Cara-PerformanceUpdate-FY18-web.pdf>; <https://www.guidestar.org/profile/36-4268095>; <https://www.ilsos.gov/corporatellc/CorporateLlcController>.
4. Data used to build this case write-up are drawn from: <https://simplecitizen.com/>; <https://www.wired.com/2015/11/this-turbotax-for-immigration-lets-you-skip-the-legal-fees/>; <https://secure.utah.gov/bes/details.html?entity=10188931-0143>; <https://www.crunchbase.com/organization/simplecitizen>.

## Disclosure statement

No potential conflict of interest was reported by the author(s).

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